IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 188.

In the Matter of

ALBERT E. McKENZIE, as Trustee in Bankruptcy of GRAVES-QUINN CORPORATION,

Petitioner,

—against—

IRVING TRUST COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF FOR PETITIONER

DAVID MORGULAS,
Counsel for Petitioner.

M. CARL LEVINE,
ALBERT FOREMAN,
Of Counsel.

M. CARL LEVINE, MORGULAS & FOREMAN,
Attorneys,
Office & Post Office Address,
521 Fifth Avenue,
Borough of Manhattan,
New York, N. Y.

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Opinions Below.

The opinions below officially reported are those of the Appellate Division of the Supreme Court of the State of New York at 266 App. Div. 699, and the opinion of the Court of Appeals of the State of New York, at 292 N. Y. 347. The opinion at Special Term of the Supreme Court, New York County is not officially reported and appears in the Record at pages 59 to 62, inclusive.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 237(b) of the Judicial Code, 28 U. S. C. 344 (b). The order of the Court of Appeals was rendered April 13, 1944. The petitioner's application for a Writ of Certiorari was filed June 23, 1944, and the Writ was granted October 9, 1944.

History of the Case.

This action was originally brought by petitioner predicated on two causes of action (R. 22). The first cause of action sought to set aside a transfer of $150,000. made by the bankrupt to the respondent as being preferential within the meaning of Section 60-a of the Bankruptcy Act. The second cause of action sought to nullify the transfer on the ground that it was void within the meaning of Section 15 of the Stock Corporation Law of the State of New York.

Prior to the judgment of the Court of Appeals of the State of New York, the second cause of action was severed by order of the Supreme Court of the State of New York, so that the instant action might proceed as if only the first cause of action had been instituted, and the instant judgment final (R. 64). Accordingly, we will proceed on the theory that the action concerns itself *ab inito* only with the first cause of action.

After issue had been joined, respondent moved for summary judgment as permitted by Section 113 of the Rules of Civil Practice of the State of New York (R. 3). The respondent's motion for judgment was on the sole ground that the transfer did not take place within four months of the bankruptcy petition.[1] It was heard at a Special Term of the Supreme Court of the State of New York and the motion denied on the ground that the alleged preference did occur within the four months period. The respondent then appealed to the Appellate Division of the Supreme

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1 The reply affidavit of Wm. A. Onderdonk makes this clear at (R. 47-48):

> "We are not, however, on this motion trying all the issues raised by the pleadings. We are concerned with only one. The Court is asked to determine if as a matter of law the transfer complained of did not occur more than four months before the filing of the petition".

Court of the State of New York (R. 4) which reversed the order of the Special Term and judgment was rendered for the respondent dismissing the complaint (R. 65). Your petitioner thereupon appealed to the Court of Appeals where the judgment of the Appellate Division was unanimously affirmed.

Application was then made to this Court for a Writ of Certiorari which was granted October 9, 1944.

Statement of the Case.

Facts.

The complaint is briefly to the effect that on November 28, 1940, exactly within four months of the filing of the involuntary petition in bankruptcy, the bankrupt, while insolvent, made a transfer of $150,000 to the respondent bank for a past consideration at a time when the latter had reasonable cause to believe that the bankrupt was insolvent within the meaning of Section 60-a of the Bankruptcy Act.

In September of 1940, the Bankrupt entered into a contract with the United States for the construction of military housing facilities at a price of $1,008,800. The Standard Accident & Insurance Company delivered its performance and payment bond to the Government and simultaneously therewith and under date of October 2nd received an assignment from the Bankrupt of all funds to become due from the Government (R. 50B&C). On October 24th, 1940 the contractor borrowed $40,000 from Respondent for a 10-day period, the Respondent expecting repayment within a week (R. 32). On November 15th, 1940 the contractor was indebted to the respondent for about $85,000 (R. 32). At this point it clearly appeared that the contractor was in financial difficulty and the respondent feared that if work stopped,

the surety company might step in and complete the construction and at the same time obtain all payments from the Government. In order, therefore, to lend an appearance of normalcy, the respondent continued to lend the contractor more money with the intent of seizing the next payment to become due from the Government before the surety's attention could be drawn to the contractor's financial difficulties. The respondent's officers then started a series of discussions as to how they might best extricate themselves from their precarious situation (R. 33).

Toward the end of November, 1940 the Government was considering a substantial progress payment to the Contractor. At that time many of the subcontractors were unpaid (R. 49). The respondent's officers feared, and with justification, that the surety company might at that moment step in and take over the job under its right of subrogation and receive all Government payments. The Bank had real reason to fear that it might lose its loans. In an effort to circumvent this, the Bank under date of November 22nd, 1940, obtained from the Bankrupt an assignment of all moneys under the contract, but withheld filing it with the Secretary of War for his approval, or giving the surety notice, as required by the Federal Assignment of Claims Act. This was not because of ignorance, but was deliberate, inasmuch as the Bank knew filing was essential to the validity of the assignment.*

The concealment had for its objective the acquirement of the Government payment before the surety or the cred-

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* This appears in respondent's own inter-office memorandum of November 15, discovered at respondent's examination before trial, viz.: (R. 36)

> "They are willing to assign the contract to us but as it is dated prior to the date of the Act authorizing the assignment of Government contracts the consent of the Government will be required."

itors were made aware of the contractor's precarious position.**

On November 27th, 1940, the contractor received at Boston, a Government check in the sum of $155,865.50, and at about 10 P. M. of the same day mailed the check to the respondent bank for deposit in the account of the contractor, and at the same time, and in the same mail, enclosed a check to the order of respondent bank in the sum of $150,000 in repayment of certain outstanding loans, $110,000 of which had matured, $40,000 of which was not due until December 9th, 1940.

The respondent's anxiety about receiving the check lest anything happen in the interim, was so great that respondent did not even trust the ordinary processes of mail delivery. Respondent's inter-office memorandum of November 28th states: (R. 34)

> "We had sent a special messenger to the post office at various times, we had been unable to obtain the check * * * about 2 o'clock the check arrived. The envelope bore Boston post mark (10 P. M.) yesterday."

It is also conceded that the records of the Bank indicate that on November 28th the Government check was deposited in the bankrupt's account and that on November 28th the sum of $150,000 was withdrawn from the contractor's account in payment of its note obligations to the respondent. This was only after the Bankrupt had delivered its check

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** This also clearly appears from the respondent's own memorandum of November 27, viz.: (R. 33)

> "Messrs. Cobb, Petersen, Keenan and the writer discussed this case and arrived at the decision that upon receipt of the check covering November 18th requisition, which would repay company's indebtedness to us, we should inform them of our unwillingness to make any further advances unless the surety companies would give us some satisfactory undertaking not to come between us and payments due Graves-Quinn under the contract, which have been assigned to us".

for $150,000 to the order of the respondent. The bankrupt's notes were then cancelled and marked paid on November 28th (R. 53-58).

The assignment was not filed with the four agencies as required by the Federal Assignment of Claims Act until December 2nd, 1940, and was not approved by the Secretary of War until December 5th, 1940 (R. 13-14). The petition in bankruptcy was filed on March 28th, 1942, exactly four months within the date of the repayment of the $150,000 to the respondent bank.

The Issue.

The Trustee contends that an assignment of moneys due under a Federal contract as collateral for a past indebtedness is void as against a Trustee in Bankruptcy, unless the assignment is filed and approved and notice given as provided by the Assignment of Claims Act, more than four months prior to bankruptcy. The Trustee contends that the doctrine of "relation back" or "inchoate assignment" can not be invoked in order to give the assignment validity as of the date of its delivery without the four month period if the statutory requisites as to filing and notice had not been complied with until a date within the four month period. The Court of Appeals held that the assignment effected an inchoate transfer and that if the filing statute was subsequently complied with—the assignment acquired a retroactive finality on the theory of "relation back." The Trustee urges that this is contrary to the word and meaning of Section 60-a of the Bankruptcy Act as it was expounded by this Court in *Corn Exchange Nat. Bank & Trust Co.* v. *Klauder*, 318 U.S. 434. The date of the validity of the assignment as against the Trustee is of paramount importance since the assignment was patently for a past consideration.

Specification of Errors.

The New York Court of Appeals erred:

1. In holding that although an assignment of moneys to become due under a Federal contract may be invalid unless filed, nevertheless, once filed the assignment has retroactive validity as of the date of its delivery as against a Trustee in Bankruptcy.

2. In holding that no bona fide purchaser or creditor could acquire superior rights to the Federal moneys so assigned between the date of the execution of the assignment and the date of filing and giving of notice as provided for by the Assignment of Claims Act.

3. In holding that an unfiled assignment of Federal moneys takes precedent over a prior assignment to the surety for the bankrupt under the Federal contract in question.

4. In holding that the doctrine of inchoate assignment or "relation back" insofar as it may apply to the assignment of Federal moneys was not repudiated by this Court in *Corn Exchange Bank* v. *Klauder*, 318 U. S. 434.

Statutes Involved.

The relevant parts of the Statutes having an important bearing on the case are set out in Appendix "A" annexed to this brief.

Summary of Argument.

Until the respondent complied with Section 3477 of the Revised Statutes as amended October 9, 1940, the assignment to respondent was null and void (I, pp. 8 to 13).

The assignment was not effective until at least December 2, 1940, within the meaning of Section 60-a of the Bankruptcy Act (II, pp. 14 to 17).

The doctrine of "relation back" was repudiated by this Court in *Klauder v. Corn Exchange Bank*, 318 U. S. 434 (III, pp. 18 to 19).

On November 22nd the Bankrupt, having previously assigned to the Standard Accident & Surety Company, had no power to make an assignment to the respondent, and at least until the respondent complied with filing and notice requirments, the surety's rights were superior under the doctrine of *Martin v. National Surety*, 300 U. S. 588 (IV, pp. 20 to 22).

The assignment in question, involving a contract and warrant of the United States, Federal Law and not State Law, was applicable (V, pp. 22 to 24).

The Court committed serious error in disregarding the book entries of the Bank under date of November 28th VI, pp. 24 to 26).

POINT I.

Until the respondent complied with Section 3477 of the Revised Statutes as amended October 9, 1940, the assignment was null and void as against the Trustee in Bankruptcy.

Prior to October 9th, 1940, assignment of claims against the United States were absolutely null and void in accordance with the express statutory language of Section 3477 of the Revised Statutes (31 U. S. C. A. Sec. 203).*

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* The statute provides:

> "All transfers and assignments made of any claims upon the United States * * * and all powers of attorney, orders, or other authorities for receiving payment of any such claim—shall be ABSOLUTELY null and void, unless they are freely made—after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof * * *."

The section was amended under date of October 9th, 1940 (Public Law 811 of the 76th Congress).* The amendment is set forth in full in the appendix. It clearly states that as to contracts executed prior to the date of its enactment (the contract in suit being executed September 14th, 1940), assignments may be taken out of the realm of nullity provided certain conditions are complied with, viz:

1. The assignment must have the consent of the Head of the Department concerned.

2. The assignee shall file written notice thereof and file a true copy thereof in various Governmental offices; *plus the surety on the contractor's bond.*

Thus, it was not only the evident purpose of the amendment to provide certain exceptional circumstances where an assignment might be given validity but in requiring notice to the surety it was the evident purpose of the amendment to strike down any secret assignments.

It is also highly significant that when the amendment to the Assignment of Claims Act was passed by Congress on October 9, 1940, the Federal Reserve Banks issued circular letters to their respective member banks warning them of the necessity of giving notice of assignment in order to make their assignments effective.

> "It is the consensus of opinion that the filing of notice of assignment together with a true copy of the instrument of assignment must be filed with each party designated in the proviso numbered 4 of the Act, as a prerequisite to the validity of assignment of claims due or to become due under a Government contract."

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* Now known as the "Assignment of Claims Act".

(Section 26254.2, page 26210 of Prentice Hall "National Defense & Government Contracts".)

At Section 26212, page 26203 of the same volume, appears a reference to the following bulletin No. 14686 of the Comptroller General's office issued February 4, 1941:

> "Necessity of strict compliance: An assignee who does not comply, at least substantially with the requirement of filing a written notice and a true copy of the assignment, would appear to have no enforceable right against the Government."

Up to the time respondent complied with the amendment of October 9, 1940, its rights must of necessity be judged under the old statute, no more, no less. As it read prior to October, 1940, Congress was most explicit. The statute did not stop at the usual phrasing "null and void", and as if that were insufficient warning Congress used the extreme admonition "absolutely null and void".

The rule in bankruptcy with respect to assignments of the instant character was enunciated by this Court in *National Bank of Commerce* v. *Downie*, 218 U. S. 345, wherein the very question at bar was considered, namely, the effect of an assignment of Federal moneys as against the right of a trustee in bankruptcy. In the cited case, the plaintiff bank was a creditor, holding an assignment of certain claims which the bankrupt had against the Government. The referee in bankruptcy had ruled that as against the trustee in bankruptcy the assignment was valid. In reversing the referee in bankruptcy and holding the right of the trustee in bankruptcy superior to the bank, this Court said at page 351:

> "The words of that section are so clear and explicit that there cannot be, we think, any reasonable ground

to doubt the purpose of this legislation. Its essential features are not new, as can be seen by an examination of the Act of Congress of July 29, 1846, 'in relation to the payment of claims' on the United States, and the act of February 26th, 1853, 'to prevent frauds upon the treasury of the United States'. 9 Stat. 41, c. 66; 10 Stat. 170, c. 81. Turning to Sec. 3477, we find Congress had in mind not only all transfers and assignments of any claim on the United States, or part of a claim or any interest therein, whether the transfer or assignment be absolute or uncon''tional and whatever was the cause of the transfer or assignment, but all powers of attorney, orders or other authorities for receiving payment of any such claim, or of any part or share thereof. All such transfers, assignments, powers of attorney, order of authorities are declared to be 'absolutely null and void', except there be a compliance with the conditions fully set out in the statute. None of these conditions was complied with in these cases."

The Court of Appeals apparently disregarded the *Downie* case on the assumption that its force was dissipated by the opinion of this Court in *Martin* v. *National Surety Company*, 300 U. S. 388.

We respectfully submit that although the *Martin* case liberalizes the rule under the special circumstances there present, it did not involve bankruptcy principles and this Court specifically pointed out that it did not intend to overrule the *Downie* case. In the *Martin* case this Court was dealing with a most special circumstance wherein it sought to prevent a fraud, and it accordingly invoked every equitable principle for the benefit of unpaid labor and materialmen and thereby upheld an assignment to a surety company. That this was the basis of this Court's decision is apparent from the following, viz. (p. 595):

"If the Government has any interest in the outcome of this controversy it is in sustaining the assignment to the surety rather than destroying it.* The contractor undertook that materialmen would receive their money promptly while the work was going on. In failing to pay them, he violated a duty to them, but a duty also to the Government, for the default was a breach of the condition of the bond. If the assignment to the surety creates a lien upon the fund, the contractor will be compelled to fulfill the duty thus assumed."

Our case presents a far different situation from that present in the *Martin* case. Here the appellant trustee seeks to invoke the protection of the Statute prohibiting assignments in order to prevent a fraud against creditors, *i.e.*, the consummation of the bank's illegal preference. In the *Martin* case the Statute was in large part disregarded because its protection was invoked by one who was guilty of fraud, not one who sought to avoid a fraud.

It is highly significant that what this Court was dealing with in the *Martin* case was not the rights of the ordinary assignee, but the policy of recognizing the rights of the surety as co-extensive with those of the Government or as this Court said (p. 597):

"Far from defeating or prejudicing the interests of the Government, the recognition of the equities growing out of the relation between the contractor and the surety will tend, as already has been suggested, to make those interests prevail" (p. 597).

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* The assignment is contained in the indemnity agreement which the contractor delivered to the surety company on receiving the construction bond required by statute (40 U. S. C. 270). It is almost identical with the assignment contained in the indemnity agreement given by the contractor in the instant case to the Standard Accident Ins. Co.

Two recent opinions deal with the apparent conflict between the *Downie* and *Martin* cases. In both, assignments of Federal moneys and rights of a Trustee in bankruptcy were involved. Each come to opposite conclusions. In *Meadow Sweet Farms, Inc.*, 32 Fed. Supp. 119, the Court held an assignment void as against a trustee, stating at page 119:

> "The Supreme Court held in National Bank v. Downie, 218 U. S. 345 * * * where the controversy as to the right to the fund was, as here, between a trustee in bankruptcy and a prior assignee, that assignments not in accordance with the statute were null and void. In Martin v. National Surety Company, 300 U. S. 588, * * * the Court announced a more liberal view of the statute under other circumstances, but did not overrule the Downie case. I think the Downie case must control."

In *Matter of Weber Motor Co.*, 52 Fed. Supp. 742, the Court upheld an assignment although it did not comply with Revised Statutes 3477 as amended October 9, 1940, stating at page 343:

> "The case upon which the trustee primarily relies, National Bank of Commerce v. Downie, 218 U. S. 345, * * * would seem to support his contention, but it is our opinion that the broad construction therein adopted must yield to the limited construction adopted by the Supreme Court in the case of Martin v. National Surety Co., supra. The later interpretation is clearly consistent with the language and purpose of the statute. Any distinctions between the cases which we should attempt to draw would be tenuous."

POINT II.

The assignment was not effective until at least December 2nd, 1940, within the meaning of Section 60-a of the Bankruptcy Act.

In *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434, this Court definitely held that failure to record rendered an assignment void as against a Trustee and that the test of what constitutes a preferential transfer under Section 60-a of the Bankruptcy Act must be considered in light of the contemplated purpose of striking down secret liens.

It was the evident purpose of the amendment to the Assignment of Claims Act of October 9th, 1940, to not only compel filing, if any validity was to be given to the assignment, but further to give notice not only to various Governmental agencies but to the principal and largest potential creditor, to wit, the Surety Company. The Miller Act (40 U. S. C. 270a) requires every contractor to furnish a surety company bond guaranteeing the payment of labor and materials, and as such the surety company always has a most vital interest in the disposition of any of the Government funds. In that capacity the surety represents practically all of the various creditors on the specific job because if failure occurs, it is the surety that is called on to pay and steps into the rights of practically all creditors.

The instant assignment was not filed until December 2nd, and consent was not obtained until December 5th. There is no contention that notice was given to anybody prior to December 2nd. On the contrary, the bank deliberately withheld filing to ward off suspicion of surety and creditors until it was repaid. If the surety knew of the assignment prior to receipt of the Government check for $155,865.50, it needs no argument to contemplate the immediate steps the surety would have taken to insure that the bank could not get preferential treatment.

Most applicable, therefore, is this Court's opinion in the *Klauder* Case that Congress by the 1938 amendment to Section 60-a of the Bankruptcy Act intended to strike down these secret financings.

Collier on Bankruptcy, 14th Ed., Vol. 3, Sec. 60, p. 892: aptly states the point:

> "The test is drawn so as to direct judicial investigation of the transfer to a time when such transfer has become, legally speaking, notorious or publicly known, and has lost any aspects of secrecy such as lack of recording or change of possession."

And again at page 898:

> "The result of the test is, of course, that there are two times of transfer, so to speak. As between the transferor and transferee obviously the time of transfer is the date of the original execution of the transaction, but as to creditors and the rest of the world, it is not a complete 'transfer' under Sec. 60 until the act has been done which by applicable law signifies to the world that the property interest transferred is no longer a part of the debtor's assets."

In the *Klauder* case this Court condemned such secrecy *where notice was required only to the debtor.* How much more obnoxious are secret assignments where a Federal Statute not only requires filing but *notice to the largest creditor—the Surety.* Yet the Court of Appeals ignored the admonition of this Court in the *Klauder* case and condoned secret assignments by invocation of the repudiated doctrine of "relation back".

In applying the test in our case the Court of Appeals went completely astray in holding (292 N. Y. 347 at 358-9):

> "The appellant, however, fails to point out any rule whereby a bona-fide purchaser for value or a creditor

could have any rights in the moneys which might become due under the contract before they were paid to the contractor or its assignee; except perhaps a lienor under the provisions of the Lien Law of this State."

This is patently wrong.

I. *As to Creditors.*

Let us first apply the test as to the right of creditors against the respondent if bankruptcy occurred prior to the receipt of the Government check. Every Federal authority that we have been able to find is directly to the effect that any creditor furnishing labor and materials as well as the surety company would have a right to the Government fund prior to and superior to the right of the assignee bank.

American Surety Company v. *Westinghouse Electric Co.*, 296 U. S. 133;
Jenkins v. *National Surety Co.*, 277 U. S. 258;
Prairie State Bank v. *U. S.*, 164 U. S. 227.

Even if the assignee actually received the money and the same were traceable that superior right would still exist.

Martin v. *National Surety Company*, 300 U. S. 588;
Cox v. *New England Equitable Insurance Co.*, 247 Fed. 955.

II. *As to Bona Fide Purchasers.*

Neither the respondent bank nor any one else ever contended that a bona-fide purchaser who took an assignment and obtained the consent of the War Department, and advanced moneys thereon, would not have a superior right to the respondent bank with its unfiled assignment given for a past consideration. The right of a bona-fide purchaser as

against a prior assignee of a Government claim where filing was provided for was expressly upheld in

Judson v. *Corcoran*, 58 U. S. (Howard) 612.

It was there most directly held that a second assignee who gives notice to the Government (where notice was permitted), and thereafter collects, is entitled to the fund as against the first assignee. It is also highly significant that the *Judson* case was cited with approval in *Salem* v. *Manufacturers Finance Co.*, 264 U. S. 182, urged by respondent and cited by the Court below.

The Court of Appeals relied on *Salem Trust Company* v. *Manufacturers Finance Company* (*supra*), (where no filing statute and only a simple assignment was involved), for the proposition that filing of the assignment at bar was unnecessary. The Salem opinion clearly indicates that it is limited to the rights of successive assignees where no notice to the debtor is required or permitted by statute. The Court below also completely overlooked the essential distinction that the Salem case had nothing to do with the question as to when an assignment might be deemed to be perfected within the meaning of the Bankruptcy Laws. That express distinction was pointed out in *Corn Exchange National Bank* v. *Klauder* (*supra*), wherein this Court said in footnote 8 to its opinion:

> "The decision in Salem Trust Co. v. Manufacturers' Finance Co., 264 U. S. 182, that, as a matter of 'general law' absence of notice to the debtor of the assignment of his account did not open the door to a subsequent assignee to obtain superior rights was not rendered in a bankruptcy case and is in any event inapplicable since the decision in the Tompkins case."

POINT III.

The doctrine of "relation back" was specifically repudiated by this Court in *Klauder* v. *Corn Exchange Bank*, 318 U. S. 434.

The Court of Appeals held that the delivery of the assignment before filing created an inchoate transfer of the assigned rights, and that once filed the assignment was given validity as against the Trustee as of its original date of delivery. This holding is directly contrary to the letter and spirit of Section 60-a of the Bankruptcy Act and to the holding of this Court in *Corn Exchange National Bank* v. *Klauder*, 318 U. S. 434.*

In referring to the effect of the *Klauder* case on the doctrine of "relation back" Moore's Collier on Bankruptcy, 14th Ed. Supplement (1943), 60.38 page 56, note 24 is most instructive:

> "The doctrine of 'relation back' a device which permitted many a secret lien to escape the effects of Section 60 prior to the 1938 Act is dead. The Supreme Court in Corn Exchange Nat. Bank & Trust Co. v. Klauder (supra) n. 21 took special note that the draftsmen of the 1938 Act expressed a firm intention to prevent its survival."

It is highly significant that even the respondent conceded in the Court below that in the absence of the filing of the assignment and the consent of the Secretary of War, it would have no right under the assignment. It attempts to accomplish the right under the assignment *ab initio* on the theory of "relation back" and the Court of Appeals put

* See footnote #1] to this Court's opinion in *Corn Exchange National Bank* v. *Klauder* (*supra*).

its stamp of approval on that theory directly contrary to the decision of this Court in *Klauder* v. *Corn Exchange National Bank* (*supra*).

The Court below stated that when the contractor received the check on November 27th it was in good faith bound to deliver the same to the respondent in accordance with the executed assignment. That erroneously presupposes that the assignment was valid, for nowhere else can the source of any legal liability be directed. In so holding the Court of Appeals entirely misconceived the purport of Section 60-a of the Bankruptcy Act, for under that Section the Trustee could have intervened on November 27th and prevented the payment. At that time there was no such perfected assignment as would prevent the Trustee from acquiring a superior right. It is entirely immaterial what would have been the respective obligations as between assignor and assignee, if no one else had a right to intervene, but to say that the contractor was bound to deliver the check to respondent bank on November 27th is to beg the very question involved, which is: Could the Trustee in Bankruptcy or any creditor have prevented such a transfer on November 27th, or could the surety company, a creditor, which had a prior assignment, have prevented a transfer on that day, or could a bona fide purchaser have acquired a superior right? The Court below entirely overlooked the fact that on November 27th the surety company was actually a creditor, and that in effect, the moneys in question belonged to it, unless its rights were affected by actual compliance with the Assignment of Claims Act. It further completely disregarded the potentiality that a bona-fide purchaser could have acquired a superior right.

POINT IV.

The Standard Accident and Insurance Company was a creditor who had and acquired rights in the property transferred prior to the time the respondent complied with the filing and notice requirements of the Assignment of Claims Act. Accordingly, the assignment to respondent was not perfected as against the trustee until at least December 2nd, 1940.

The Court of Appeals must have realized that the actual transfer of $150,000 took place on November 28th. The Court was, accordingly, compelled to adopt respondent's contention that filing was unnecessary, and that the unfiled assignment to the respondent imposed a duty on the bankrupt to turn over the Government funds to the respondent. The Court, however, wholly lost sight of the fact that this duty could exist only if there were no prior assignment outstanding by reason of which the bankrupt owed a superior duty to the prior assignee. If, therefore, respondent is correct in its argument that filing and notice were unnecessary, it must still fail for it is then faced with a prior valid outstanding assignment to the Standard Accident Insurance Company.

The fact is, that on October 2nd, 1940, seven weeks prior to the respondent's assignment, the bankrupt had already made an assignment of the same funds to the Standard Accident Insurance Company. It was the usual assignment contained in the indemnity agreement given by a contractor to his surety upon the issuance and delivery of a performance and payment bond. We deal here with an assignment identical to that which this Court recognized in *Martin* v. *National Surety* (*supra*) as creating rights and equities superior to those of a subsequent assignee to whom the Government actually paid the contract balance. It has been repeatedly held that the surety company's rights are paramount, and date

as of the date of the original indemnity and assignment agreement. In *Barnett* v. *Maryland Casualty*, 134 F. (2d) 725 (certiorari denied 320 U. S. 740), the Court, in characterizing a similar assignment to a surety, said:

> "The assignment involved here is from its terms a present assignment and not a mere promise to assign in the future."

Thus, in our case, a prior assignment having been made to the surety on October 2nd, 1940, and the surety being a creditor, the Court of Appeals was in error in holding that the assignment to respondent on November 22nd, 1940, *per se*, gave it exclusive and unquestioned right to the fund superior to any other creditor.

The record is clear that the contractor had failed to pay its bills long prior to November 22nd, 1940. This was a default within the meaning of the indemnity agreement, and the assignment to the surety was effective under the doctrine of the *Barnett* case (*supra*), at least by November 22nd, if not as of the date of the indemnity agreement (September 14th, 1940).

The Court below misconceived the effect of the assignment to the surety, stating, at the conclusion of its opinion, that it would give no heed to the alleged rights of the surety, inasmuch as the Trustee in bankruptcy had no authority to bring an action to establish a superior title in some other person. This evaded the very purpose of the petitioner in urging the assignment to the surety. Our evident purpose was to show that the surety was a creditor, and that under Section 60-a of the Bankruptcy Act could have intervened and demanded the moneys at all times and even have traced the fund directly into the hands of the Bank, unless its rights had been cut off when the Bank complied with the Assignment of Claims Act. Certainly therefore the surety was a creditor within the meaning of Section 60-a of the

Bankruptcy Act. As a matter of fact, the very Assignment of Claims Act provided that notice must be given to the surety, for it was the evident purpose of the Act to prevent secret assignments against the interest of sureties. Had the surety known of the assignment prior to the actual receipt of the moneys by the Bank, it needs little argument to realize that the surety would have caused a petition in bankruptcy to have been immediately filed, in order to prevent the unlawful diversion of $150,000. Under Section 60-a of the Bankruptcy Act the Trustee has the right to assume the position of every conceivable creditor including the surety whose rights for the purposes of this action become those of the Trustee.

POINT V.

The assignment in question, involving a contract and warrant of the United States, Federal Law and not State Law, is applicable.

It is difficult to understand whether the Court of Appeals applied the standards of State or Federal law. In *Corn Exchange National Bank & Trust Co. v. Klauder (supra)*, this Court construed an assignment of moneys purportedly made in accordance with Pennsylvania statutes. In determining the effect of lack of notice of the assignment under the Pennsylvania statutes, this Court held that the standards which applicable State law would enforce against a purchaser for value must be applied. Seizing upon that phrase, the Court of Appeals applied the State law test to the assignment of Federal moneys at bar, stating (292 N. Y. 347 at 358):

> "The 'standards which applicable State law would enforce against a purchaser for value' or against a creditor must be applied here. (Corn Exchange National Bank & Trust Co. v. Klauder, 318 U. S. 434.)"

The Court was in error. It should have applied the tests of Federal law, inasmuch as both a Federal statute and Federal moneys were involved.

Clearfield Trust Co. v. *United States*, 318 U. S. 363.

It would be an entirely different matter if Federal statutes did not require filing, and if Federal funds were not directly involved and their disbursement regulated by Federal statute.

The effect of the holding of the Court of Appeals would make the Assignment of Claims Act dependent upon the law of each state. Thus, an assignment of federal funds made pursuant to Federal statute, might be invalid in one state and valid in another. That the Court of Appeals could have come to this result is all the more inexplicable in view of its holding in *Manhattan Commercial Co.* v. *Paul*, 216 N. Y. 481. In that case the Court of Appeals had occasion to consider a purported assignment of a claim against the United States and the rights arising therefrom prior to the Assignment of Claims Act. The Court held that the assignment failed to conform to the requirements of the Statute and not only declared the assignment void by reason of the Federal Statute, but because of the opinion of this Court in *National Bank of Commerce* v. *Downie*, 218 U. S. 345, the Court of Appeals stating at page 485:

> "We accept such decision* as an authority, and, controlled by it, hold that the present assignment or transfer or authorization was likewise absolutely null and void as between the plaintiff, Vermilye & Power and the defendant and did not vest in the plaintiff any right whatsoever, legal or equitable, to the moneys paid by United States on the claims to Vermilye & Power.

* Referring to the decision of this Court in *National Bank of Commerce* v. *Downie*, 218 U. S. 345.

> The language of the statute and of the opinion in the National Bank of Commerce case interdicts further discussion."

It is noteworthy that the Court of Appeals completely ignored its own decision in *Manhattan Commercial Co. v. Paul*, 216 N. Y. 481, although its attention was specifically called to it.

POINT VI.

The Court of Appeals committed reversible error in disregarding the book entries of the Bank under date of November 28th.

Irrespective of the effective date of the assignment it is our contention that the actual preference took place on November 28th. It is conceded that on November 27th the Bankrupt received in Boston the Government check payable to its order for $155,865.50, and late that evening mailed it to the respondent bank *for deposit in the Bankrupt's account. It is undisputed that on November 28th the Bank actually deposited this check for $155,865.50 in the Bankrupt's account,* and that on the same day it accepted the check of the Bankrupt drawn to the order of the respondent bank in the sum of $150,000, and on November 28th withdrew that amount from the Bankrupt's account and cancelled four promissory notes of the Bankrupt totalling $150,000.

The Court below, however, determined that these transactions were to be disregarded.* Thus, instead of adhering

* The opinion makes this impossible justification for the court's holding:

> "The book entries of the bank on November 28th by which the check received by the contractor from the government was deposited in the account of the contract and the check of the contractor to the order of the bank in payment of indebtedness to the bank, merely constituted a record of the transaction in compliance with the directions of the contractor" (R. 77).

to the record, the Court invoked the fiction that when the bankrupt actually received the check on November 27th, it held the same on behalf of the Bank by reason of the assignment and thus completely disregarded that which was actually done. *In re National Lumber Co.*, 212 Fed. 928, at page 929, is most pertinent:

> "The parties chose to pay and to accept the money in the ordinary course of events, and their conduct is to be judged by what they did, not by what they might have done. Bank v. Campbell, 81 U. S. (14 Wall.) 87, 20 L. Ed. 832."

If the respondent had acted on the assignment, and regarded the Government check as its property, it would not have deposited the Government check to the bankrupt's credit and account, and then gone through the additional step of having the bankrupt make out a check for $150,000 to the respondent's order so that the respondent might cancel $150,000 of the outstanding notes of the bankrupt; $100,000 of which were payable on demand, and $50,000 not due until December 9th. The moment the Government check was deposited in the bankrupt's account, the money belonged to the bankrupt—a debtor and creditor relationship had already arisen. No matter what previous claim the Bank might have had to the Government check, it had relinquished it. Certainly it did not act on any claim of title. On November 28th the proceeds of the Government check were in the bankrupt's name, and it was obviously necessary for the Bankrupt to take some affirmative step to transfer the $150,000 to respondent.

If what the respondent contends were actually in the contemplation of the respondent, it never would have deposited the Government's check in the Bankrupt's account. The fact is that the Bank knew on November 22nd, the date it received the assignment, that it could not become effective

until the Bank obtained the consent of the Secretary of War and gave the requisite notice.

The deposit of the check in the Bankrupt's account and the payment on November 28th fixes November 28th as the date of the preferential payment, and the Respondent can trace no legal right to the funds by reason of the assignment until Respondent complied with the Assignment of Claims Act as to filing and notice. Since that date is concededly within the four month period of the bankruptcy petition, the transfer is subject to attack by the Trustee in Bankruptcy.

CONCLUSION.

The judgment of the Court of Appeals of the State of New York should be reversed and respondent's motion to dismiss the complaint denied.

Respectfully submitted,

DAVID MORGULAS,
Counsel for Petitioner.

M. CARL LEVINE,
ALBERT FOREMAN,
Of Counsel.

M. CARL LEVINE, MORGULAS & FOREMAN,
Attorneys,
Office & Post Office Address,
521 Fifth Avenue,
Borough of Manhattan,
New York, N. Y.

APPENDIX.

Statutes Involved.

R. S. 3477, Sec. 203, Title 31, U. S. C. Money and Finance.

All transfers and assignments made of any claim upon the United States * * * and all powers of attorney, orders, or other authorities for receiving payment of any such claim —shall be absolutely null and void, unless they are fully made—after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof.

Amendment to Section 3477, Revised Statutes (October 9, 1940)

(Public No. 811, 76th Congress.)

(Chapter 779, 3d Session.)

(H. R. 10464.)

An Act.

To assist in the National-Defense Program by Amending Sections 3477 and 3737 of the Revised Statutes to Permit the Assignment of Claims Under Public Contracts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That Sections 3477 and 3737 of the Revised Statutes be amended by adding at the end of each such section the following new paragraph:

"The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due

from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency: PROVIDED,

"1. That in the case of any contract entered into prior to the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned without the consent of the head of the department or agency concerned;

"2. That in the case of any contract entered into after the date of approval of the Assignment of Claims Act of 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;

"3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;

"4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with

"(a) the General Accounting Office,

"(b) the contracting officer or the head of his department or agency,

"(c) the surety or sureties upon the bond or bonds, if any, in connection with such contract, and

"(d) the disbursing officer, if any, designated in such contract to make payment.

Notwithstanding any law to the contrary governing the validity of assignments, any assignment pursuant to the Assignment of Claims Act of 1940 shall constitute a valid assignment for all purposes."

Any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.

Sec. 2. This Act may be cited as the "Assignment of Claims Act of 1940".

Approved, October 9, 1940.

Section 60-a of the Bankruptcy Act as amended by the Chandler Act of June 22nd, 1938, 52 Stats. 840, 869-870; 11 U. S. C. Sec. 96-a.

§ 60. PREFERRED CREDITORS.—a. A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy, or of the original petition under chapter X, XI, XII or XIII of this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. For the purposes of subdivisions a and b of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor

could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII or XIII of this Act, it shall be deemed to have been made immediately before bankruptcy.